

Fundamentals: Terminology

Legal: Financial Aspects of Insurance

Insurance is a financial agreement that must be legally defined.

Insurance is a financial arrangement that redistributes the costs of unexpected losses

Ex. 1000 homeowners / One year's Coverage
.1% loss rate

$\Rightarrow .1\% \times 1000 = .001 \times 1000 = 1$ Home Destroyed

Total Loss \Rightarrow \$250,000 if \$250,000
Each home is insured for

Premium = $\frac{\$250,000}{1000 \text{ homeowners}} = \250

Insurance : Risk

Def: Insurance

- ① Pooling of losses subject to chance
- ② Financial Risk transfer mechanism
- ③ Indemnification

Law of large numbers - Greater the number of exposure units the lower the variation of actual from expected results.

Benefits of Insurance to Society

- ① Indemnification for loss
- ② Loss Prevention
- ③ Less Worry & Fear
- ④ Source of Investment Funds
- ⑤ Enhancement of Credit

Costs of Insurance to Society

- ① Cost of Doing Business - Expense loading
- ② Fraudulent Claims
- ③ Inflated Claims

Risk Management

Defn A systematic process for the identification and evaluation of pure loss exposures faced by an organization or individual, and for the selection and implementation of the most appropriate techniques for treating such exposures.

Objective

- Pre-loss - - Prepare for losses
- Consider effective ways to handle loss
- Reduce Anxiety
- Meet Externally imposed obligations

Post Loss Objective

- ① Survival of the firm
- ② Continuation of Operations
- ③ Stability of Earnings
- ④ Continued growth of the firm
- ⑤ Social responsibility

Risk Mgt Process

- ① Policy Statement
- ② Risk identification
- ③ Evaluate Potential Loss
- ④ Selection of Appropriate risk mgt. technique
- ⑤ Implement / evaluate / administer the program.

Fortuitous loss - one that is unforeseen and unexpected

Indemnification - The insured is restored to his/her's approximate financial position that existed prior to loss

Elements of An Insurable Risk

- ① Large # Exposure Units
- ② Accidental and Unintentional loss
- ③ Determinable & Measurable loss
- ④ Not Catastrophic
- ⑤ Calculable Chance of Loss
- ⑥ Economically feasible Premium

Adverse Selection

⇒ The tendency of persons with a higher than average chance of loss to seek insurance coverage at standard rates.

Underwriting

⇒ The process of selecting & classifying risks for coverage by an insurer

Types of Insurance

Private Insurance

Life & Health Insurance

Property & Liability Insurance

Public (government) Insurance

Social Insurance

Deposit Insurance

Fed. Employee Retirement System

Flood Insurance

Legal Liability Insurance -

Provides protection against the financial impact of law suits

Liability arises out of the common law notion that people are responsible for injury to others.

3 Categories of Events Causing Injury

- ① Breaches of Contracts
- ② Criminal Acts
- ③ Torts or Civil Wrongs

Breach of Contract - failure, without legal excuse, to perform contractual duties

Criminal Acts - Crimes or wrongs against society

Torts or civil wrongs - unreasonable conduct toward another person

The same action (e.g. battery) may be both a criminal and a civil wrong.

Negligence - involves doing something a reasonable person would not do, or not doing something a reasonable person would do which directly results in injury to another.

Types of Negligence

- Vicarious
- Joint-and-several Liability

Negligence Lawsuits

of Parties $\left\{ \begin{array}{l} \text{Plaintiff} \\ \text{Defendant} \end{array} \right.$

Necessary Conditions for Negligence

The plaintiff is required to prove all of the following:

- ① Defendant had a legal duty to protect the plaintiff
- ② Defendant failed to perform that duty
- ③ The plaintiff suffered injury as a result of the defendant's failure to perform that duty.

Establishing Negligence & Damages

Attractive Nuisance

Compensatory Damages

Death Injuries

Personal Injuries

Property Damages

Punitive Damages

Gross Negligence

Res ipsa loquitur - the facts speak for themselves, allows the jury to infer negligence